

INTERNAL REVENUE SERVICE
Director, Exempt Organizations

DEPARTMENT OF THE TREASURY
1100 Commerce Street
Dallas, Texas 75247

COPY

Date: JUN 29 2000

Employer Identification Number:
[REDACTED]

Person to Contact:
[REDACTED]

Contact Telephone Number:
[REDACTED]

In Response, Refer To:
[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code.

You were incorporated on [REDACTED], in [REDACTED]. Your Articles of Incorporation indicate that you are organized for the following purposes:

- a. To own and operate a water supply facility for drinking water and general use which services all lots as platted or to be platted as part of [REDACTED].
- b. To own and operate a sewage collection and treatment facility which services all lots as platted or to be platted as part of [REDACTED].
- c. To promote the general welfare, safety, health and recreation of [REDACTED].
- d. To establish and conduct business as a homeowner and community improvement association for the benefit of lots as platted or to be platted as part of [REDACTED].
- e. To administer all community funds generated by assessments in [REDACTED] for water, sewer, trash, [REDACTED] general maintenance.
- f. To own, establish, operate, regulate and maintain the roads and common areas in [REDACTED].

[REDACTED] (the developer) developer.
[REDACTED] (the subdivision). Your officers and
members are also officers and board members for the developer.

[REDACTED]
[REDACTED]
[REDACTED] (the subdivision) contains [REDACTED] lots. Individual homeowners own [REDACTED] lots. The remaining [REDACTED] lots are owned by the developer, including a lot used for the sewer treatment facility. The subdivision also includes [REDACTED] acres that have not yet been platted. There are no churches, schools, businesses, etc. within the subdivision.

Currently, the developer also owns the common areas in the subdivision, which consist of the entrance to the subdivision, the lot where the treatment plant is located, and the roads. The developer paid the construction costs for the sewer treatment facility, the roads, etc. The developer intends to donate these areas and transfer ownership to you if exempt status is granted.

Your Articles of Incorporation indicate that you have two classes of members. Class A members are individual homeowners in the subdivision. They are entitled to one vote for each lot owned. There is one Class B member, the developer. The Class B member is entitled to 3 votes for each lot owned.

The Articles of Incorporation also indicate that the Class B membership will cease and be converted to Class A membership at the earlier of:

- a. The total votes outstanding in the Class A membership equal the total votes outstanding in the Class B membership; or
- b. The seventh anniversary of the date of the adoption of the [REDACTED]
[REDACTED]

As of [REDACTED], [REDACTED] votes were held by Class A members and [REDACTED] votes were held by the Class B member.

All residents of the subdivision are required to receive water and sewer services from you. These services are currently being billed at \$[REDACTED] per month.

Membership dues are \$[REDACTED] per year. This amount is expected to cover the costs of maintenance for the common areas other than the sewer treatment facility.

Section 501(c)(4) of the Internal Revenue Code provides, in part, for the exemption of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare. No part of the net earnings may inure to the benefit of any private shareholder or individual.

Sections 1.501(c)(4)-1(a)(2)(i) and (ii) of the Income Tax Regulations state, in part, that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the

[REDACTED]

community. An organization embraced within this section is one that is operated primarily for the purpose of bringing about civic betterments and social improvements. An organization is not operated primarily for the promotion of social welfare if it is carrying on a business with the general public in a manner similar to organizations that are operated for profit.

Revenue Ruling 72-102, 1972-1 C.B. 149, describes an organization formed by a developer to preserve the appearance of a housing development and to maintain streets, sidewalks, and common areas for the use of the residents, which was found to be exempt under section 501(c)(4) of the Internal Revenue Code. The rationale behind this decision was that the organization served the common good and general welfare of the entire community because it owned and maintained certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments. Administering and enforcing covenants for preserving the architecture and appearance of a housing development was incidental to the overriding public interest.

Revenue Ruling 74-99, 1974-1 C.B. 131, attempted to clarify the definition of "community". It stated that a "community" within the meaning of section 501(c)(4) was not merely "an aggregation of homeowners bound together in a structured unit formed as an integral part of a plan for the development of a real estate subdivision and the sale and purchase of homes therein." Although it was stated that an exact delineation of the boundaries of a "community," within the scope of section 501(c)(4) was not possible, it was noted that the term as used in this section "has traditionally been construed as having a reference to a geographical unit bearing a reasonably recognizable relationship to an area ordinarily identified as a government subdivision or a unit or district thereof." No minimum size was set.

In Revenue Ruling 77-273, 1977-2 C.B. 194, an organization that provided security services for residents and property owners was determined to be carrying on a business with the general public and did not qualify for exemption under section 501(c)(4) of the Internal Revenue Code.

Based on the information presented, we have concluded that you do not meet the requirements for exemption as a social welfare organization described in section 501(c)(4) of the Internal Revenue Code. Unlike the organization described in Revenue Ruling 72-102, furthering the interests of the property owners in a subdivision is your primary purpose.

As in Revenue Ruling 74-99, you were formed by a commercial real estate developer as an integral part of a plan for the development of a subdivision. The developer has control of the association and its board of directors until the association no longer serves the private business interest of the developer. You do not possess the necessary

"community" characteristics outlined in the Revenue Ruling in order to overcome the private benefit issues.

Further, by providing water and sewer services on a regular basis for a set fee you are carrying on a business with the general public like the organization described in Revenue Ruling 77-273 that failed to qualify for exemption under section 501(c)(4).

Accordingly, it is held that you are not entitled to exemption from Federal income tax as an organization described in section 501(c)(4) of the Internal Revenue Code, and you are required to file Federal Income Tax Returns using Form 1120.

If you do not agree with these conclusions, you may, within 30 days from the date of this letter, file in duplicate a brief of the facts, law and argument that clearly sets forth your position. If you desire an oral discussion of the issue, please indicate this in your protest. The enclosed Publication 892 gives instructions for filing a protest.

If you do not file a protest with this office within 30 days of the date of this report or letter, this proposed determination will become final.

If you agree with these conclusions or do not wish to file a written protest, please sign and return the enclosed Form 6018.

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Steven T. Miller

Steven T. Miller
Director, Exempt Organizations

Enclosures:

Publication 892
Form 6018

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